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RUEHKM/AMEMBASSY KAMPALA 3128
RUEHNR/AMEMBASSY NAIROBI 5571
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RHEHAAA/NSC WASHDC

UNCLAS SECTION 01 OF 03 HARARE 000624

SENSITIVE
SIPDIS

AF/S FOR B. WALCH
DRL FOR N. WILETT
ADDIS ABABA FOR USAU
ADDIS ABABA FOR ACSS
STATE PASS TO USAID FOR J. HARMON AND L. DOBBINS
STATE PASS TO NSC FOR SENIOR AFRICA DIRECTOR MICHELLE GAVIN

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SUBJECT: MID-YEAR FISCAL REVIEW SETS RIGHT TONE FOR RECOVERY

Summary

¶1. (SBU) The mid-year fiscal review by Finance Minister Tendai Biti upgraded the economic growth forecast from 2.8 percent to 3.7 percent due to a projected 24.3 percent growth in agriculture and an anticipated upturn in business confidence arising from implementation of policies contained in the Short Term Economic Recovery Program (STERP). The proposed suspension of import tariffs on capital goods and raw materials is likely to improve capacity utilization in industry overall, though the reintroduction of royalty payments in the gold sector may dampen its nascent recovery. The lack of affordable credit continues to constrain industry's ability to take advantage of regulatory improvements. END SUMMARY.

Economy forecast to grow in 2009

¶2. (SBU) In his mid-year fiscal review statement to Parliament on July 16, 2009, Minister of Finance Tendai Biti projected that the economy, which declined by a cumulative 48 percent between 2000 and 2008, would grow by 3.7 percent in ¶2009. Biti stated that agriculture would contribute most to this recovery, with a projected growth rate of 24.3 percent growth due to a number of initiatives including direct budgetary allocations, subsidized credit and increased demand. Biti told Parliament that long-term growth in agriculture would largely depend on restoration of security of tenure on land and "strengthening property rights in the form of long leases, title deeds and certificates of occupation."

¶3. (SBU) The Minister expected the manufacturing and tourism sectors to contribute positively to the projected growth due to the policy effects of STERP. He advised Parliament that capacity utilization among manufacturers had improved from

around five percent to 25 to 30 percent between January and June 2009. Biti stated that the mining sector was expected to decline by 11.2 percent in 2009 due to low prices of metals such as nickel and asbestos. Construction was also forecast to decline in 2009.

Inflation expected to remain subdued

¶4. (SBU) Biti told Parliament that implementation of prudent policies resulted in the country recording month-on-month deflation between January and May 2009, although the rate of decline in more recent months was lower due to monopolistic pricing by public enterprises and local authorities. The Finance Minister said inflation control had been aided by dollarization, and the inability to print money had forced the government to live within its means. He implored local authorities, parastatals and businesses to act responsibly when reviewing rates and setting prices to avoid reigniting inflation. On this basis, he projected that inflation would end the year at 6.4 percent, down from the 6.9 percent forecasted at the beginning of March 2009.

Financial sector to be overhauled

¶5. (SBU) Biti said that the financial sector had been adversely affected by the hyperinflationary environment and

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by 2008 bank assets were a quarter of their 2004 value. He told Parliament that most institutions responded to this erosion of value by closing branches in rural areas, leaving 65 percent of the population without ready access to banking services; savings needed to finance investment were consequently affected. He expressed confidence that recovery in the financial sector was progressing, pointing to the growth in deposits from US\$200 million in February to US\$706 million by the end of June. Biti bemoaned the low loans-to-deposit ratio of only 37.3 percent, urging banks to do more to raise the ratio. He urged banks to raise deposit interest rates and he suspended the 10 percent withholding tax on interest payments to non-residents to attract more deposits. His goal was to raise deposits from 4 percent of GDP to 25 percent. Biti also removed the 5 percent tax on bank profits and promised to review cutting reserve requirements to improve market liquidity.

¶6. (SBU) Biti told Parliament that 15 of the 28 financial institutions in the country had complied with the minimum capital requirements ahead of the September 2009 deadline, leaving 13 below the threshold. He said he decided to phase in the minimum capital requirements, proposing that banks achieve 50 percent of the expected capital by the end of September 2009 and 100 percent by the end of March 2010.

Rest in ease Zimbabwe dollar

¶7. (SBU) Biti completed the process of dollarization by demonetizing the remaining Zimbabwe dollar cash in circulation and balances with financial institutions. He set aside US\$6 million to purchase the remaining stock of Zimbabwe dollars. He further ruled out the return of the Zimbabwe dollar until the country developed a sustainable external position and a strong financial sector capable of supporting and sustaining its own currency.

Reforming the Reserve Bank of Zimbabwe

¶8. (SBU) The Finance Minister told Parliament that the government had agreed on proposed changes to the Reserve Bank Act designed to enshrine the institution's operational independence, forcing it to concentrate on its core business of supervising and regulating the financial and monetary system. He also said that the government would recapitalize the RBZ once the process of establishing the assets and liabilities of the institution had been completed.

Budget performance to June commendable

¶9. (SBU) Biti told Parliament that between January and June 2009, the government managed to collect US\$285.4 million against a target of US\$321.2 million, with the bulk of the money coming from value-added tax (US\$110.5 million), customs duty (US\$90.9 million) and pay-as-you-earn income tax (PAYE) Qduty (US\$90.9 million) and pay-as-you-earn income tax (PAYE) (US\$47.9 million). Biti noted that total expenditures were US\$257.2 million, of which US\$156.5 million went to allowances for civil servants and grant-aided institutions. He proposed that civil servants be paid salaries instead of allowances by the end of July. Salaries will be partly funded through unconfirmed donor support of US\$391 million. During the period covered by his statement, Biti said only US\$10.4 million was spent on capital projects against a target of US\$31.8 million.

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Duties on most items reduced

¶10. (SBU) Biti suspended import duties on capital goods and on most raw materials to support local industry to modernize plant and equipment and to raise capacity utilization from the current 25 percent to 60 percent by year's end. Import duty on intermediate goods was also reduced from 10-15 percent to just 10 percent. He cut import duties on fuel, replacing it with an excise duty of US20 cents per liter for petrol and US16 cents for diesel. He extended the suspension of customs duties on some basic commodities to the end of December 2009 because of the positive effect this would have on food supply and inflation. Only cigarettes and tobacco had excise duty increased from 60 to 80 percent. Biti alluded to additional changes meant to simplify the tax structure in the 2010 budget due at the end of November 2009.

Royalties re-introduced on gold

¶11. (SBU) As promised in the March budget review statement, the Finance Minister re-introduced the three percent royalty on gross revenue from gold that was suspended in 2004. According to Biti, the tax was appropriate given that most gold mines had reopened following the liberalization of gold marketing earlier this year.

Comment

¶12. (SBU) Biti's mid-term fiscal review statement contains economically-sound, pro-growth policies. The suspension and reduction of duties on capital goods, raw materials and intermediate goods is likely to result in supply increases by firms which found it difficult to replace plant and equipment during hyperinflationary times. However, credit remains a major constraint as most Zimbabwean banks are unable to access foreign lines of credit due to the country's poor credit profile--a profile which has been undermined by political infighting in the inclusive government. A worrying aspect of year-to-date budget performance is the continued

State underinvestment on capital spending, which fails to support Biti's goal of raising capacity utilization. END COMMENT

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